DRAFT – APR. 30. 2007

Testimony of

Ford Motor Company

to

House Tax Policy Committee

regarding House Bill 4367(H-1)

May 1, 2007

Thank you for the opportunity to speak to you today regarding the Michigan Business Tax Act. We are optimistic that this plan can strike a balance that is a good one for business, the state and the state's economy has a whole.

As you know, Ford Motor Company and the entire US auto industry are in the midst of historic changes in the way we do business. At the same time, Ford is rebuilding its business in North America. That includes reducing our total annual operating costs by about $5 billion by the end of 2008. As part of these cuts, we are reducing our salary-related costs by about a third, or about 14,000 equivalent salaried positions. Nevertheless, between now and 2008. 70 percent of the Ford, Lincoln and Mercury lineup will be all new or significantly freshened.

But even as we transform ourselves, this industry continues to be *the* major driver of this state's economy. Ford isn't leaving Michigan and, in fact, as we restructure our business, we're finding reasons to become even more concentrated in the state where the industry was born. A lot of good things come out of our commitment to Michigan, and not just those things that Ford and our counterparts do directly though our companies. To illustrate - the Center for Automotive Research (CAR) estimates for every automaker job, 6.5 additional jobs are created As you know. and our newspapers document on a regular basis. the competition among states to woo location of a new automobile manufacturing facility is fierce. Southern states. as well as our neighbors. are offering billions of dollars in incentives to locate new plants and facilities there. Ford. GM and DaimlerChrysler annually purchase more than $171 billion dollars from suppliers throughout the US. We know our struggles impact a lot of companies. their employees. investors and shareholders. They very distinctly impact our state and local governments in Michigan as well. Ford feels that we're doing our part to find our road to the future and appreciate the support this state and its citizens have shown to us during this process.

As we change and modernize how our company does business. we are encouraged by policymakers' recognition that Michigan's state & local tax system needs to be modernized and forward looking as well. We applaud the House leadership - - and this Committee in particular - - for their willingness to tackle a major and very sorely needed update to Michigan's tax system at this critical time. The changes this group makes to the tax system will have significant and longstanding implications on Michigan's economy and the businesses who operate here.

Under the old tax system, Michigan businesses were taxed based on their investments in this state. This new plan instead encourages investment through elimination of the personal property tax, providing business tax credits. and other rewards for economic activity in Michigan.

In addition, this tax plan is grounded in pro-investment tax policy principles. These policies include taxing businesses based on sales in the state and not on payroll and property focusing on the seller's market rather than where the costs incurred for originating those sales takes place. The House Democrats' plan also utilizes commonly-used state taxes (income and net worth) that are quantifiable and measurable based on data we gather today to comply with federal and state income tax laws and accounting principles used in our financial statements. This method assures us that we can accurately predict our tax obligations in Michigan and reduces our cost of compliance. We also recognize that the Committee has spent considerable effort learning from other states' struggles to close unintended tax loopholes and has attempted to make sure that the new business tax doesn't have these problems.

This plan's tax credits for Michigan employee compensation, capital investments and research and development expenses show also that policymakers value these contributions of businesses to Michigan's economic future. Together, the Big 3 automakers employ about 160, 000 people in Michigan. This state is and will remain the home of the automotive industry. Our future is important to Michigan's future. This plan encourages the kinds of investments that will drive the Michigan economy for decades. Ford today makes significant investments in Michigan in our manufacturing facilities as well as in engineering, research and development and headquarters jobs and equipment. A staggering amount of the total research and development spending in this country takes place right here in Michigan. The auto industry is a significant part of that. Engineers from around the world come to Michigan for research jobs and we'd like to make sure Michigan businesses can make the commitment to students graduating from our world-class universities that there's a future for them right here in Michigan. Providing an incentive for research and development expenditures in the state is a terrific way to reward and even further encourage this kind of activity here. As Ford restructures its business, we're continuing to invest in research because we know that tomorrow's car buyers will demand the latest in technological advances in safety, fuel economy and customer convenience. Even as Ford struggles, research is an important part of our business. We simply can't afford not to make these investments.

Beyond our research spending, Ford has made major commitments to invest in modern, flexible manufacturing equipment at several of our Michigan plants. As you know, we announced in January that we plan to invest $866 million in facilities here in Michigan, such as our Van Dyke Transmission plant, Wayne Stamping and Assembly plants, Michigan Truck Plant and our Stamping Plant in Dearborn as well as our plants in Livonia and Woodhaven. Rewarding businesses for making these investments is progressive future-oriented tax policy, unlike yesterday's tax systems that punished in-state jobs and capital investments.

The Michigan personal property tax remains especially burdensome and has a direct relationship to the decision to invest capital in this state. The commitment of the House to eliminate this tax completely is good Michigan tax policy and would align us with the trend states are following across the United States -- from Ohio to Arizona.

As major investors and job providers in this state, we also recognize that upgrading the state's tax system will change the funding mechanisms for our schools and local governments. We know you are committed to making sure this tax plan will continue to fund necessary state and local government services and education. What is remarkable about this plan is that it does that, as well as provide rewards to businesses who invest here. As we've told this committee before, taxes are an important issue to our company, our state's economy and state and local governments and schools. This can not and should not be ignored, and we again want to thank this body and the entire Michigan government for its courage and leadership in tackling this difficult issue. We all have an opportunity to participate in making historic changes here and we believe this tax plan is a responsible forward for all of us.

We look forward to continuing to work with you and your fellow policymakers to make Michigan the state that encourages, rather than discourages investment, and helps Michigan and businesses prosper. Thank you.

Ford

Glossary of Key State Tax Terms

March 5, 2007

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TYPES OF STATE & LOCAL TAXATION

Business Net Income Tax:
A net income tax (gross income minus deductions) on business activity, generally based on federal taxable income.

Apportionment:
The process of dividing taxable income among states where a taxpayer does business. State laws differ, but many states now apportion income to the state based on the proportion of in-state sales to total sales (the "sales factor"). Other "apportionment factors" may include payroll and property, though the weight of these items in the total apportionment percentage is almost always less than sales in order not to penalize companies with investments in property and employees in the state.

Sourcing:
Generally, a term referring to the determination of where a transaction takes place. "Situs" is a similar term referring to where a business or asset is located.

> *For sales factor apportionment purposes, "sourcing" sales based on where the "costs of performance" are incurred rather than the market where the product or service is sold or enjoyed has the same impact as including in-state property and payroll in the apportionment percentage.*

Combined or consolidated reporting:
A tax return reporting the income of a group of related businesses. There are a variety of different types of combined returns, including the federal tax return filed on a "consolidated" group basis. Some states limit the group to only companies with nexus in their state and may require taxpayers to petition the tax authority for permission to file a group return.

Most state corporate income taxes either allow or require combined reporting.

Unitary:
One specific kind of combined return based on the concept of taxing a group of related companies as one "unit" for state income tax purposes. Under this method, a unitary group files one tax return including all of the taxable income and apportionment factors of the members of the unitary group, adjusted to "eliminate" transactions among members of the group.

17 states currently require unitary groups to file as one taxpayer and several other states are considering legislative proposals to require this kind of reporting in order to preclude tax avoidance techniques.

Separate reporting:
The concept of taxing corporations (or other business entities) as stand-alone businesses, regardless of ownership or transactions between companies with common ownership. This form of reporting is relatively

The constitutionality of certain types of state tax incentives was questioned a decision of the federal Sixth Circuit in Cuno v. Daimler Chrysler. The U.S. Supreme Court determined that the plaintiffs did not have standing to bring the suit and remanded the case for the lower courts to decide. State and federal courts in NC and WI have also recently dismissed challenges to the constitutionality of incentives.

Tax haven:
A jurisdiction with little or no tax. This can be a state without an income tax (e.g., Nevada) or certain foreign jurisdictions, typically with no tax treaty with the U.S. government with regard to information sharing.

purposes. This determines whether a business is treated as a corporation, partnership or division of its owner.

Disregarded entity:
A legal entity that is treated as a division of its single owner for federal income tax purposes. Most states conform to this treatment for state income taxes, but often impose other taxes or reporting obligations at the legal entity level (e.g., sales tax and payroll taxes).

GAAP:
Generally Accepted Accounting Principles. Accounting standards used for book or financial purposes but not necessarily for federal taxes.

"Net income tax" for accounting purposes:
Taxes based on gross income minus deductions which are accounted for as "income taxes" on financial statements. These taxes are "below-the-line" expenses for publicly-traded businesses. Whether a tax is "above-the-line" or "below-the-line" impacts the earnings impact of the tax on the taxpayer.

Incentives:
Tax credits or abatements designed to induce economic development. Generally based on investment or job creation. Many incentive programs are governed by an economic development board which approves the tax incentive and draws up a contract with the taxpayer indicating the terms of the agreement.

easy for taxpayers to manipulate by shifting income to out-of-state locations (typically in low or no-tax jurisdictions).

> *"Income shifting" refers to the practice of creating deductions to move income between affiliates in order to report income to a tax haven jurisdiction. Typically, taxpayer in a separate reporting jurisdiction can deduct an expense for a payment to an affiliate in a low tax jurisdiction. The taxpayer reports less taxable income or even a loss to the separate return state. If both companies are included in a combined return, there is no ability to shift income to an affiliate that isn't subject to the tax.*

Federal taxable income:
Income subject to tax (total income minus total deductions) by the federal government. Many states use this as the starting point for calculation of state taxable income.

> *For corporations, this is reported on Line 28 or Line 30 of the U.S. 1120 corporate tax return. (Similar definitions for partnerships and sole proprietors.)*

Net Operating Loss:
The excess of deductions over income in a given tax period. For federal income tax purposes and in many states, a current-year NOL can be carried back to the 2 preceding tax years and carried forward for up to 20 taxable years.

State tax laws differ with regard to whether the federal NOL or a state NOL is allowed against corporate income taxes. State rules also differ with regard to carrybacks and the length of carryforwards.

Alternative Minimum Tax:
An alternative income tax calculation that ensures a minimum amount of tax payments in a given year. AMT payments are credits against regular tax liabilities in a future year. Federal tax law includes an AMT, as do several states like CA, MN and NY.

Gross Receipts Tax:
A tax on the amounts received from the sales of goods and services, without deduction for the costs of producing or procuring the product. While statutory rates for these types of taxes may appear very low, the effective rate of these taxes on earnings of a business is often very high especially in the case of businesses with low margins or economic losses.

Examples of gross receipts taxes include Ohio Commercial Activity Tax and Washington Business & Occupation Tax. Many states also have special industry gross receipts taxes, but few are broadly imposed on all business activity.

Margins or Gross Profits Tax:
A modified gross receipts tax, allowing some deductions against total receipts for cost of goods sold and other inputs. Texas recently enacted a margins tax on unitary

of presence or "nexus" with the state before the tax can be imposed.

The U.S. Supreme Court held that a physical presence in the state is necessary to require sellers to collect sales taxes but has never addressed what is required for income or other taxes. Several state courts have ruled that an economic presence or relationship with an affiliated business in the state is sufficient to create nexus for income tax purposes.

Foreign income:
Income from outside the U.S. but subject to federal income tax. Many states exempt foreign income from state taxation and there are constitutional restrictions on state taxation interfering with foreign commerce.

Federal tax is based on all income of U.S. persons on a worldwide basis. Some states allow an election by a taxpayer to be taxed on worldwide net income. However, the general rule is that only domestic companies and income are subject to state taxes and are therefore "water's edge" reports or exclude affiliates with 80% of property and payroll outside the U.S.

"Check-the-box":
Federal income tax regulations dealing with the classification of non-corporate business entities (for example limited liability companies) for federal income tax purposes. Most states conform to these regulations for purposes of defining a taxpayer for income tax

OTHER STATE TAX TERMS:

Nexus:
Connection with the state sufficient to allow the state to assert jurisdiction to tax. The U.S. Constitution's Commerce Clause and Due Process Clause require such connection.

PL 86-272:
Federal law limiting the ability of states to impose a net income tax on sellers of tangible goods whose only physical presence in the state is the solicitation of orders. This law was enacted by Congress in the 1950s and is very limited in scope. Since it is limited to net income taxes, some states are considering other forms of taxation (*e.g.*, gross receipts or net worth taxes) to avoid PL 86-272 disputes.

> *The Michigan SBT is not a net income tax and therefore is not subject to PL 86-272 nexus standards. For SBT purposes, a minimum presence of 2 visits to the state in a year, for any purpose, is considered to create nexus. This is similar to the standard used by other states for gross receipts taxes, sales taxes and net worth taxes.*

Commerce Clause:
U.S. Constitutional limitation on state tax authority. State taxes that discriminate against interstate commerce or are unfairly apportioned violate the Commerce Clause. The Commerce Clause also requires some type

groups of taxpayers to replace a separate entity-based franchise tax on the greater of income or net worth.

Net Worth (Franchise) Tax:
A tax on net worth usually measured by specific balance sheet items (assets, liabilities, equity) such as capital stock and paid-in capital. This is a common and very traditional type of state taxation. Rates are typically low due to the potential large values subject to tax. Many states impose a net worth tax as a minimum tax on businesses operating in the state.

Factor Tax:
A tax business activity measured by "factors" such as in-state sales and property and sometimes payroll.

Asset Tax:
A tax on assets of a business. Usually liabilities associated with those assets are not allowed as adjustments.

> *Asset taxes apportioned by a sales factor are controversial since the in-state activity has no relationship to the asset base.*

Business Activity Tax:
A tax imposed on business activity in the state based on the privilege of doing business. Such taxes are calculated based on the presence in the state and can be based on net worth, gross receipts or other measures. Generally this is not a net income tax.

Congress has been considering legislation that would create a "bright line" nexus standard for business activity taxes, similar to what is currently in place for net income taxes under federal law.

Sales Tax:
A transaction-based tax on sales of goods at retail. Tax is paid by the consumer and remitted by the seller to the state. Most states do not include sales of services.

Sales taxes generally provide exemptions for the sale of property acquired for resale or for use in production or processing. Food, clothing and other necessities are often exempt.

Use Tax:
A sibling of sales tax for use or consumption in the state. Usually a complimentary tax to a sales tax, imposing tax on those taxable items procured elsewhere but used in the state.

Excise Tax:
A tax imposed on a specific act or transaction. Sales and Use taxes are forms of excise taxes on specific transactions.

Property Tax or Ad Valorem Tax:
A tax on property owned based on its value.

Real Property Tax:

Generally a tax on both residential and business property, often assessed by a local jurisdiction.

Personal Property Tax:
A tax on tangible property owned or used by businesses. Most states include only business property. Personal property taxes often exclude manufacturing property and/or business inventory. Valuation can be difficult, but generally issues around defining exempt property and applying different rates to different types of property are most contentious. One major concern is how to value property that becomes obsolete more quickly than was anticipated when the property was placed in service.

Value Added Tax:
A tax on "value added" paid by either the supplier or consumer. Michigan SBT is a modified value added tax, based on business income then adjusting for inputs such as labor and capital and interest. Many European and Canadian jurisdictions impose VAT taxes, but the Michigan SBT is the only state tax of this type.

Premiums Tax:
A tax on insurance companies based on premiums written or earned in the state.